Sky Rocketing Oil Prices—a 'Stealth Threat' to Shipping Industry

By: Shenila Shallwani - APFA

The extraordinary rise in oil prices has an indelible impact on many industries. Being an activity that depends greatly on oil, shipping has not escaped this development.

Shipping is a crucial facilitator of much of the world's trade; hence, the rising cost of shipping as a result of the rise in oil prices is naturally a matter of great concern to the industry and beyond.

Shipping companies are decidedly edgy to market trends, particularly rising crude prices point to a more challenging year in 2012. Overcapacity across all shipping segments has put pressure on freight rates, with this being further compounded by the relentless rise in bunker prices since the beginning of 2011.

The Economist Rubin & Benjamin, argued that "the cost of moving goods, not the cost of tariffs, is the largest barrier to global trade today"

Shipping companies are facing volatile situation with regards to the high bunker fuel costs, lower demand for shipping services, depressed freight rates as well as more seriously, declining asset values of ships,"

The bunker fuel prices have risen steadily from a range around US$500 per MT in late 2010 to early 2011 to above US$700 per MT and are now hovering around US$600 per MT in 2012. Bunker prices are not expected to ease well into middle of next year and higher bunker prices would eat into any improvements in freight earnings.

"Shipping companies are being backed into a corner by rising input costs and falling freight rates," moving even larger shipping companies towards operating losses"

The spike in bunker prices has "drastically eroded" the already slim profits experienced by shipping companies, which were already saddled with the rise of other costs. They are already paying more for vessel purchase, for onboard equipment, and for repair & maintenance of their fleet. All these add pressure to the operating costs of shipping companies.

Such is the dependency of the business world on oil, that the hike in its price triggers an all-round increase in prices of many goods, materials and services.

Fuel cost represents as much as 60% of total ship operating cost. Such an increase cannot be taken lightly. Adding more vessels, steaming or sailing at lower speed, reconfiguring their routes and focusing on fuel-saving measures via incorporating technology, increasing the maintenance of their ships and increasing surcharge and bunker adjustment factor (BAF) are such solutions that shipping companies are now using to cope with the raise in bunker fuel prices to save their costs.

How carriers seek to obtain recovery of these rapidly rising fuel costs in the current market is a matter for commercial negotiations, but the significance, magnitude and the consequences of the challenge continue to grow.

The slow steaming approach adopted by shipping lines to reduce bunker consumption is good news for environmentalists as lower average speed of vessels reduces emissions by the shipping sector. High oil prices on the other hand may even provide greater impetus for greater technological Improvements of ship performance and encourage the use of alternative energy such as gas and biofuels.

The World Shipping Council has fully supported the efforts of the U.S. and other governments to establish new environmental standards for vessel air emissions, and supports the new standards that the International Maritime Organization has recently agreed for new engine standards and new fuel standards. However, the cost of low sulfur fuels to be used in Emission Control Areas will roughly double the cost of bunker fuel, thus creating even more upward operating cost pressures going forward.

It is important to recognize that ocean shipping is the most energy efficient form of freight transportation. Recent estimate shows that moving goods by ocean container can be 17 times more fuel efficient than transporting the same goods by air and 10 times more efficient than transporting the goods by road. However, increase in International fuel prices is affecting the current variable service cost of shipping industry.

So even if we go pass this cyclical problem with the recovery of the global economy, there is limited chance of the freight rates moving up because of the overhang in the supply of shipping capacity. "This can be very structurally damaging for the shipping industry because several shipping lines are already trying to keep their heads above waters and counting on the upturn in the freight market, which may be elusive, given the current situation,"

Surviving under the current situation is going to prove very difficult to many shipping lines and it is important that the Government takes some initiatives to introduce some supportive measures to help the industry. "Given the fact that shipping is the lifeline of our trade dependent economy, it is important to address the concerns of the industry to ensure that growth of trade is not jeopardized,"